Issues and Challenges in Corporate and Capital Market Law: Germany and East Asia

Edited by
HOLGER FLEISCHER, HIDEKI KANDA,
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Max-Planck-Institut
für ausländisches und internationales
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und internationalen Privatrecht
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Mohr Siebeck

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Preface

This volume is based on presentations delivered at a symposium held in March 2016 at the University of Tokyo. The symposium is part of a conference series organized to stimulate the scholarly exchange between company law academics in Germany, China, Japan and South Korea which can be traced back to the late 19th century. The organizers are convinced that this exchange will be very fruitful in solving the challenges for company and capital markets law in the 21st century. A follow-up conference has already taken place in Seoul in March 2017.

We would like to express our gratitude to our Japanese hosts for unforgettable days in Tokyo. Furthermore, we would like to thank all participants for their valuable and much appreciated contributions. Janina Jentz and Jakob Hahn took care of the editing process, their help is gratefully acknowledged. Last but not least, our sincere thanks go to Jocasta Godlieb and Michael Friedman for providing valuable language editing service.

Hamburg, Tokyo, Seoul and Mainz
January 2018

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III. Civil Liability of the Company and Its Directors when Financial Statements are False

IV. Corporate Law Rules on Squeeze-out of Minority Shareholders

Abbreviations

ADHGB	Allgemeines Deutsches Handelsgesetzbuch
AEA	Act on External Audit of Joint Stock Corporations
AG	Aktiengesellschaft
AktG	Aktiengesetz
BAG	Bundesarbeitsgericht
BB	Betriebs-Berater
BGB	Bürgerliches Gesetzbuch
BGH	Bundesgerichtshof
BGHZ	Entscheidungen des Bundesgerichtshofs in Zivilsachen
CEO	Chief Executive Officer
CMA	Financial Investment Services and Capital Markets Act
CMFIBA	Capital Market and Financial Investment Business Act
CPA	Certified Public Accountant
CRD	company-recipient-division
CSR	Corporate Social Responsibility
CSRC	China Securities Regulatory Commission
DB	Der Betrieb
DStR	Deutsches Steuerrecht
ECFR	European Company and Financial Law Review
ed.	edition
EGTC	Estate and Gift Tax Code
EU	European Union
FIEA	Financial Instruments and Exchange Act
FSC	Financial Services Commission
FSS	Financial Supervisory Service
FTC	Fair Trade Commission
GmbH	Gesellschaft mit beschränkter Haftung
GmbHG	Gesetz betreffend die Gesellschaften mit beschränkter Haftung
GMS	General Meeting of Shareholders
GPCL	General Principles of Civil Law
HGB	Handelsgesetzbuch
IFRS	International Financial Reporting Standards
IPO	initial public offering

JCA	Japanese Company Act
JFSA	Japanese Financial Service Agency
KCC	Korean Commercial Code
KCML	Korean Capital Market Law
KEGTL	Korean Estate and Gift Tax Law
KG	Kommanditgesellschaft
KGaA	Kommanditgesellschaft auf Aktien
KRX	Korean Stock Exchange
LG	Landgericht
LLC	Limited Liability Company
LLP	Limited Liability Partnership
M&A	Mergers & Acquisitions
MOJ	Ministry of Justice
MRFTA	Monopoly Regulation and Fair Trade Act
NJW	Neue juristische Wochenschrift
NZG	Neue Zeitschrift für Gesellschaftsrecht
OHG	Offene Handelsgesellschaft
OLG	Oberlandesgericht
PRC	People‘s Republic of China
SFC	Securities and Futures Commission
SOEs	State-owned enterprises
SpruchG	Gesetz über gesellschaftsrechtliche Spruchverfahren
SR	Shareholder resolution
SRD	shareholder-recipient-division
StGB	Strafgesetzbuch
UK	United Kingdom
UmwG	Umwandlungsgesetz
US	United States of America
WpHG	Wertpapierhandelsgesetz
WpÜG	Wertpapiererwerbs- und Übernahmegesetz
ZGR	Zeitschrift für Unternehmens- und Gesellschaftsrecht
ZHR	Zeitschrift für das gesamte Handels- und Wirtschaftsrecht
ZIP	Zeitschrift für Wirtschaftsrecht

I. Corporate Divisions
(or more generally, Umwandlung)

The German Law on Transformation

Principles and Experiences after 20 Years of the Codification of German Transformation Law

Rüdiger Veil

I. Introduction

In Germany company transformations have long played a major role. The first merger took place in 1831, when several coal mines merged to form the *Vereinigungsgesellschaft für Steinkohlebergbau.*[1] In 1861, the legislator in-

[1] R. GOLDSCHMIDT, Die sofortige Verschmelzung (Fusion) von Aktiengesellschaften (Berlin 1930) 5. At that time, a legal basis for a merger did not consist. It had to be approved by the Prussian state.

troduced the first legal basis for a merger.[2] Since then, numerous reforms have been implemented in order to facilitate company transformation.[3] Thus far, this development has culminated in the codification of transformation law via the Transformation Act of 28 October 1994.[4] The purpose of this Act is to provide suitable procedures for the various forms of transformation and adequately protect minority shareholders as well as creditors.

As a codification of fundamental principles and laws, the German Transformation Act aims to regulate all kinds of mergers, divisions and changes of legal form.[5] Its systematic structure is similar to the German Civil Code (BGB), first providing a general section for all types of transformation followed by general and specific sections for mergers, divisions and the change of the legal form of a company.

This article provides an overview of the different types of transformation, explains which principles apply and analyses the main instruments of shareholder and creditor protection. It concludes with a discussion of whether the German Transformation Act has proven its value in practice as a tool for regulating transformations, by considering the merger between *Deutsche Börse* and *London Stock Exchange* concluded by the management of both companies in 2016, but failed one year later. The focus is on mergers and divisions (split-up, spin-off and hive-down), which are characterised by a transfer of assets and liabilities through so-called universal succession. Hence, the instruments of creditor and shareholder protection are essentially the same. This article does not deal with change of a legal form.[6]

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[2] Art. 247 ADHGB of 1861 (Allgemeines Deutsches Handelsgesetzbuch – German Trade Code).

[3] Between 1961 and 1991, 12 reforms took place in Germany. Cf. R. VEIL, Umwandlungen in: Bayer/Habersack (eds.), Aktienrecht im Wandel der Zeit, Volume 2 (Tübingen 2007) 1066–1087.

[4] German Transformation Act (Umwandlungsgesetz – UmwG) of 28 October 1994, BGBl. I 1994, p. 3210. The German Federal Ministry of Justice and Consumer Protection in cooperation with juris GmbH provides an English translation of the Act. It is available at: <http://www.gesetze-im-internet.de/englisch_umwg/>.

[5] The UmwG exclusively regulates types of transformation (so-called *numerus clausus* of transformations, cf. § 1 para. 2 UmwG). However, some types of a transformation are not covered by the UmwG. This is particularly true for specific changes of a legal form of a partnership. In addition, transformations by way of singular succession are not precluded by the Transformation Act. See T. DRYGALA, in Lutter (ed.), Umwandlungsgesetz, 5th ed. 2014, § 1 marg. no. 52.

[6] The legal structure of a company may be modified by way of a change of legal form (§ 190 UmwG). This type of transformation preserves the legal identity of the company (so-called "identitätswahrende Umwandlung"). For more detail see T. RAISER/R. VEIL, Recht der Kapitalgesellschaften, (6th ed., Munich 2015) § 67 marg. no. 21–23.

II. Types of Transformation

1. Merger

The prototype of a transformation is the merger. When merging by way of absorption[7] the assets of one legal entity are transferred to another legal entity,[8] and the entity being acquired is dissolved.[9] Shares in the acquiring legal entity are allotted to the owners of shares in the legal entity being acquired. In contrast, when merging by way of a newly formed legal entity,[10] a new legal entity is formed through allotment of the total assets of two or more legal entities to a separate, newly formed legal entity. As soon as the assets have been allotted to the new entity, the acquired entities are dissolved.

Mergers mostly take place within a group of companies. In practice, the merger of a subsidiary into the parent company *(upstream merger)* is more common, but the merger of a parent company into the subsidiary *(downstream merger)* and the merger of two sister companies *(sidestream merger)* also occur frequently. The merger of two independent companies remains an exception in Germany, although it does occur now and then. The most prominent example is the merger between the *Thyssen AG* and the *Friedrich Krupp AG Hoesch-Krupp* forming the *ThyssenKrupp AG*[11] (so-called merger of equals).

The Transformation Act also provides the possibility of a cross-border merger of companies limited by shares.[12] The key distinguishing feature of such a merger is that at least one of the companies involved must be subject to the laws of another Member State of the EU.[13] However, nowadays owing to a change in preferred practice, large cross-border transactions generally do not take place in accordance with the provisions laid down in the Transformation Act. For example, in case of the current merger between *Deutsche Börse* and the *London Stock Exchange* the management boards have agreed to

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[7] § 2 no. 1 and §§ 4 et seq. UmwG.

[8] Legal entities eligible for mergers are commercial partnerships, companies limited by shares, registered cooperative societies, registered associations, confederations responsible for auditing cooperative societies and mutual insurance companies. See § 3 para. UmwG.

[9] A merger becomes effective with the entry in the register kept at the registered seat of the acquiring legal entity. See § 20 para. 1 UmwG.

[10] See § 2 no. 2 and §§ 36 et seq. UmwG.

[11] The corporations merged in order to meet the challenges of the globalization of plant engineering and steel industry. See OLG Düsseldorf, ZIP 1999 793 und OLG Hamm, ZIP 1999 798.

[12] §§ 122a–122l UmwG.

[13] A challenge for cross-border mergers is that different valuation principles apply. See T. KOHL, A Comparison of Valuation Principles in Germany and Internationally, in: Rödder/Bahns/Schönfeld (eds.), Cross-Border Investments with Germany – Tax, Legal and Accounting, In Honour of Deltev J. Piltz (Cologne 2014), 601–612.

combine the businesses under a UK holding company with the shares of Deutsche Börse AG acquired pursuant to a public takeover, and thus outside the purview of the German Transformation Act.[14] The merger between *Linde AG* and the US-American *Praxair Inc.* will be structured in the same way.[15]

2. Division into Several Enterprises

The division into several enterprises can take place as a split-up, spin-off or hive-down.[16] In case of a split-up, the legal entity[17] transfers its assets to two or more legal entities. Afterwards it is dissolved. In return, its shareholders are allotted shares of the new legal entities,[18] which either already exist or have been newly formed for this purpose. By contrast, in a spin-off, only a part of the legal entity's assets is transferred to a legal entity either already in existence or newly formed[19] and the legal entity transferring the assets also continues to exist. In return, the shareholders are allotted shares of the acquiring legal entity. A hive-down[20] also only involves part of the assets, but the shares of the acquiring legal entity are allotted to the legal entity transferring its assets (and not its shareholders), creating a clear distinction between spin-offs and hive-downs.

Hive-downs occur, for instance, when an enterprise incorporates a subsidiary and transfers parts of its assets to that subsidiary. Split-ups or spin-offs may be considered when two or more families hold shares of one legal entity and wish to part. Moreover, split-ups and spin-offs take place when an enterprise wants to confine itself to its core business, allowing those parts of the business no longer needed to be sold or taken public. A prominent example is the spin-off of the former Osram division of the *Siemens AG.* As consideration for the spin-off, Siemens shareholders were allocated shares in *Osram Licht AG.*[21]

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[14] See in more detail below V.4.b).

[15] R. KÖHN, Linde betreibt die Fusion an seinen Aktionären vorbei, Frankfurter Allgemeine Zeitung (FAZ), 20 January 2017, 19.

[16] § 1 para. 1 no. 2 and § 123 UmwG.

[17] The legal entities eligible for a merger may generally also be involved in a split-up, spin-off or hive-down as legal entities transferring assets, as acquiring legal entities, or as newly formed legal entities. See § 124 para. 1UmwG.

[18] § 123 para. 1 UmwG.

[19] § 123 para. 2 UmwG.

[20] § 123 para. 3 UmwG.

[21] For more detail see the joint spin-off report of the management boards of Siemens AG and Osram Licht AG, submitted pursuant to section 127 Transformation Act. The English version of the report is available at: <https://www.siemens.com/investor/pool/en/investor_relations/events/annual_shareholders_meeting/2013/auslage-top-8-spaltungsbericht_final_en.pdf>.

3. Conclusion

The German Transformation Act provides the greatest possible degree of freedom when it comes to corporate restructuring and allows almost all conceivable types of company transformation. Companies have made extensive use of the possibilities provided in the Act.[22] For example, in 2004 and 2005, stock corporations were involved in more than 1,000 mergers and about 200 split-ups.[23]

III. Universal Succession

1. Agreement

The legal basis for a merger or a division is an agreement, which stipulates the details of the transformation process.[24] The merger or division agreement is entered into by the management board of the legal entities participating in the transformation. As German law understands mergers and division as structural changes that are decided by the shareholders, the agreement is not effective until a resolution has been passed at a general meeting. Thereby it has not yet become effective.[25] Thus, when a stock corporation is participating in a merger or a division, a resolution via a general meeting is required.

The most important point of the agreement is that the transfer of assets occurs by universal succession. In the event of a merger, all assets and liabilities of the legal entity being acquired are transferred as a whole to the acquiring legal entity. In case of a division, the legal entity may split-off a part of its assets and liabilities and transfer it to the acquiring legal entity.[26] This entails the transfer of liabilities and contracts, including any transferrable rental or lease agreements.

In case of a merger, approval is not required from creditors or contractual partners. This is meanwhile also true for a division. However, in 1994, the German legislature sought to achieve a high level of creditor protection by

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[22] Official statistics do not exist. However, it can be concluded from publicly available data that mergers and divisions often take place and are an important way of a transformation. Cf. W. BAYER/T. HOFFMANN, Restrukturierung von Aktiengesellschaften durch umwandlungsrechtliche Maßnahmen, AG 2006 R468.

[23] W. BAYER/T. HOFFMANN, Restrukturierung von Aktiengesellschaften durch umwandlungsrechtliche Maßnahmen, AG 2006 R469–R470.

[24] § 5 UmwG (merger) and § 125 UmwG (division) specify the minimum substance of the respective agreement.

[25] The agreement shall enter into force only if the owners of shares in the legal entities involved consent to the agreement by a resolution (See § 13 para. 1 and § 125 UmwG).

[26] § 20 para. 1 no. 1 regarding a merger and § 131 para. 1 no. 1 UmwG regarding a division.

applying the "general rules precluding the transferability of a specific asset and the general rules making the transferability of an object subject to conditions or requirements",[27] with the goal of preventing abuse of a division to the detriment of creditors.

This rule gave rise to a number of difficult questions of interpretation.[28] In particular, whether the transfer of liabilities would require the consent of a creditor was the subject of some controversy.[29] In 2007, the legislature decided to repeal section 132 of the Transformation Act, thus clarifying that a transfer of contracts and liabilities in the course of a division does not require the consent of the contractual partner and creditors, arguing these would be sufficiently protected.[30] In fact, creditors may rely upon different instruments of civil law and corporate law, exercising general rights under civil law, such as the right of termination and the right of withdrawal for frustration. Furthermore, creditors are protected under a specific liability rule under the Transformation Act.[31]

2. Entry in Commercial Register

Following the shareholders' resolution, the transformation does not become effective until it has been entered into the Commercial Register. Only then are the assets transferred to the acquiring legal entity. It is also at this point that the shareholders of the acquired legal entity become shareholders of the acquiring legal entity.[32]

Under the Transformation Act, the legal effect of a transformation is irreversible.[33] Hence, a merger or a division cannot be reversed, even if a severe defect of the transformation becomes evident after entry in the commercial register. Though this has been criticised by a number of academics,[34] arguing

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[27] § 132 UmwG (since repealed).

[28] See in more detail T. RAISER/R. VEIL, Recht der Kapitalgesellschaften, (4th ed., Munich 2006) § 49 marg. nos. 28-30.

[29] According to the former predominant opinion, a number of rights, such as not freely transferable shares (vinkulierte Geschäftsanteile) of a limited liability company (GmbH) and pre-emptive purchase rights could not be transferred. Cf. H. SCHRÖER, in: Semler/Stengel, Umwandlungsgesetz, 1st ed. 2003, § 132 marg. nos. 31-49.

[30] Explanatory remarks governmant draft, Zweites Umwandlungsrechtsänderungsgesetz, BT-Drucks. 16/2919, 19.

[31] See below IV.3.

[32] See § 20 para. 1 no. 3 UmwG regarding a merger and § 131 para. 1 no. 3 UmwG regarding a division.

[33] See § 20 para. 2 and § 132 para. 2 UmwG: Defects of the merger/division will not have repercussions on the effects of its entry in the register.

[34] Cf. K. SCHMIDT, Haftungsrisiken bei "steckengebliebenen" Verschmelzungen?, DB (1996) 1860; R. VEIL, Umwandlung einer Aktiengesellschaft in eine GmbH (Berlin 1996) 163; C. SCHMID, Das umwandlungsrechtliche Unbedenklichkeitsverfahren und die

the rule affects the fundamental rights of a shareholder, the legislature has justified the rule with the argument that it would be scarcely possible to reverse merger or division transactions, particularly after several years.[35] Instead of an *ex post* cancellation of a merger or division, the Transformation Act provides a broad range of *ex ante* protections for shareholders.

3. Conclusion

The transfer of assets and liabilities by way of universal succession is an important element of German transformation law and allows a flexible and cost-efficient transformation of companies. However, in cross-border matters (e.g. when real estate is located abroad) the question arises whether foreign law recognises the principle of universal succession. If not, assets have to be transferred individually.[36]

IV. Protection of Creditors

1. Foundations

Under German law, creditors do not have any influence on a transformation. However, both mergers and divisions can be disadvantageous for creditors. With a merger, creditors are confronted with a new debtor. In the case of a division an additional problem arises: the recoverable assets are reduced, as the acquiring legal entity and the legal entity being acquired are generally not limited in how they divide their assets and liabilities.

Hence, a key object of transformation law is to provide necessary protection for creditors. Interestingly, the system of creditor protections in Germany has changed fundamentally from 1897 to 1994. Initially, transformation law required the separation of the property for a certain period of time (six months).[37] This approach was abandoned due to numerous practical difficul-

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Reversibilität registrierter Verschmelzungsbeschlüsse, ZGR 1997, 510; C. SCHÄFER, Die „Bestandskraft" fehlerhafter Strukturänderungen im Aktien- und Umwandlungsrecht – zu neuen, rechtlich nicht vertretbaren Ausdehnungstendenzen und zu ihrer prinzipiellen Ungeeignetheit, missbräuchliche Anfechtungsklagen einzudämmen, in: Bitter et al. (eds.), Festschrift für Karsten Schmidt (Cologne 2009) 1389 et seq.; C. SCHÄFER, Die Lehre vom fehlerhaften Verband (Tübingen 2002) 181 et seq.

[35] Explanatory remarks government draft, § 20 UmwG, published by J. GANSKE, Umwandlungsrecht (Düsseldorf 1994) 75.

[36] B. GRUNEWALD, in: Lutter, Umwandlungsgesetz, 5th ed. 2014, § 20 marg. no. 11.

[37] R. VEIL in: Bayer/Habersack (eds.), Aktienrecht im Wandel, Vol. 2 (Tübingen 2007) 1059, 1063, 1065, 1070.

ties and unresolved legal issues.[38] Instead, a more flexible system evolved from 1937–1980 and was adopted by the legislature in 1994 for all types of transformations.

First, the Transformation Act requires that a merger or division for the purpose of forming a new entity can be done only if the provisions governing the formation of the acquiring legal entity are respected.[39] Additionally, the Transformation Act provides several protective rules. These are: the obligation to provide security (section 22), special provisions for the protection of holders of non-voting preference shares (section 23) and claims for damages against wrongful acts of board members (section 25). For divisions, the Transformation Act also stipulates that the entities involved in the division are liable for the debts, obligations and responsibilities of the legal entity being acquired (section 133). In the following, I will focus on the most important elements: the claim for provision of security as well as the liability of legal entities involved in a division.

2. Claim for Payment of Security

If the creditors of legal entities involved in a merger or division cannot demand satisfaction for their claims, security is to be provided to them, provided they file their claim in writing within six months of the merger being registered.[40] This also applies when their claim is not yet due.[41] Furthermore, creditors must provide credible evidence that the fulfilment of their claim could be jeopardised by the transformation. In the event of either a merger or a division, this requirement might be fulfilled if the acquiring legal entity to which the liability has been transferred is endangered, which may be assumed if the equity capital base is diminished.[42] However, this condition is not satisfied if the acquiring company is simply conducting high-risk business.[43]

The duty to provide security is not an unfair burden on companies as only those creditors who are not sufficiently secured are entitled to it. This protective measure has proven its value in practice. It becomes especially relevant

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[38] C. BÖTTCHER/H. MEILICKE, Umwandlung, Verschmelzung und Auflösung (Berlin 1937) § 241 marg. no. 1.

[39] This becomes relevant if an insolvent company is involved in a transformation. Cf. E. WÄLZHOLZ, Aktuelle Probleme der Unterbilanz- und Differenzhaftung bei Umwandlungsvorgängen, AG 2006, 469.

[40] § 22 para. 1 and § 125 UmwG.

[41] B. GRUNEWALD in: Lutter, Umwandlungsgesetz, 5th ed. 2014, § 22 marg. no. 9.

[42] B. GRUNEWALD in: Lutter, Umwandlungsgesetz, 5th ed. 2014, § 22 marg. no. 12; O. VOSSIUS, in: Widmann/Mayer, Umwandlungsrecht, May 2016, § 22 marg. no. 29.

[43] B. GRUNEWALD in: Lutter, Umwandlungsgesetz, 5th ed. 2014, § 22 marg. no. 12.

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